IN THE

United States

Circuit Court of Appeals

FOR THE NINTH CIRCUIT

ERNA KORN and MUTUAL SECURITIES COMPANY, *Appellants,* vs. SPOKANE & EASTERN TRUST COMPANY, *Appellee.* B. SCHADE BREWING COMPANY, B. SCHADE and L. R. STRITESKY, *Defendants.*	No. 3693

Appeal from the District Court for the Eastern District of Washington

APPELLEE'S BRIEF

F. H. GRAVES,
W. G. GRAVES,
B. H. KIZER,
Spokane, Washington
Solicitors for Appellee.

EMPIRE-PACIFIC PRINTING CO., SPOKANE

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STATEMENT OF THE CASE.

The statement made in the appellants' brief is very far from being the concise abstract of the salient facts of the case which the rules contemplate, so we shall endeavor to supply the lack.

This is a shareholder's suit, brought by the appellant Korn, a shareholder in the B. Schade Brewing Company, against the Spokane & Eastern Trust Company, a banking house of Spokane, the B. Schade Brewing Company, and B. Schade and L. R. Stritesky, officers of the Brewing Company, for the purpose of setting aside a conveyance of the property of the Brewing Company to the Trust Company and recovering possession of the property from the Trust Company; the theory of the bill of complaint being that the conveyance was *ultra vires,* and was not properly authorized. Another shareholder, the Mutual Securities Company, praying the same relief as the original plaintiff, was permitted to intervene. A trial upon the merits was had, and the bill was dismissed as devoid of equity. The plaintiff and the intervenor prosecute this appeal.

The B. Schade Brewing Company is a Washington corporation, incorporated in 1903. In the original articles of incorporation, the objects for which it was organized were stated to be the manufacture and

sale of beer and the acquisition of property for the purposes of such business (Tr., 4). In 1907 the corporate objects were enlarged by an amendment of the articles of incorporation, in addition to other powers it taking the power "to purchase, acquire, * * * lease, mortgage, sell and convey breweries, malt houses, bottling works and ice and fuel manufacturing plants and machinery; to purchase, lease, own, operate, mortgage, sell and convey real and personal property for any purpose which the corporation may deem expedient or necessary to aid in, increase, or protect any business it may now or hereafter become engaged in." (Tr., 81.) It constructed a brewery in Spokane, and there engaged in the business of making and selling beer, and in no other business, until the Washington prohibition act became effective on 1st January, 1916. It then made a futile attempt to operate a soft drink establishment, but the business did not pay and was conducted for but a very short time. It then ceased all business (Tr., 63, 64).

During the period here involved, the Brewing Company had an issued capital stock of 5,000 shares. B. Schade owned 2,606 shares, Sophia Schade, his wife, 50 shares, and L. R. Stritesky, 91 shares. The other shareholdings were scattered, officers in the Spokane & Eastern Trust Company, and persons to whom they had recommended the stock, owning several hundred shares (Tr., 57, 62, 93). The board of directors consisted of Mr. and Mrs. Schade and

Stritesky. During the prosperous years of the business, before the prohibition shadow fell upon it, shareholders quite generally attended the corporate meetings. When the business ceased to pay, the shareholders lost interest and no longer attended the meetings, so that, as Stritesky testified, "for a number of years before the transaction ended the stockholders' meeting consisted of the Schades and myself," and the three were left to run the corporation as they pleased (Tr., 61-63).

Prior to 1914 the Brewing Company had become indebted to the Spokane & Eastern Trust Company in the sum of $50,000, for money loaned to and used by the Brewing Company in its business. In 1914 this indebtedness was evidenced by promissory notes executed by the Brewing Company and secured by a mortgage upon all its property. The notes were guarantied by Schade, but the debt was a corporate debt and Schade's guaranty was purely an accommodation guaranty, made because of his relation to the corporation. When prohibition became effective in Washington, and the business of the Brewing Company was destroyed, it was left without a dollar, and has no resources from which to pay interest on its indebtedness or taxes or insurance on its property (Tr., 63-64). Its affairs being hopeless, the Trust Company assigned the notes and mortgage to the State Finance Company, a subsidiary corporation of the Trust Company, for purposes of suit, and the Finance Company brought a foreclosure suit,

joining B. Schade as defendant, to recover upon his guaranty of the debt, and making Mrs. Schade a defendant for the purpose of having Schade's guaranty adjudged to be a community debt (Tr., 91-92, 124-133). The Schades answered separately, as did the Brewing Company. The case was set for trial, when a compromise and dismissal of the suit was effected upon these terms: The Brewing Company caused the mortgaged property to be conveyed to the Trust Company, and the latter caused the foreclosure suit to be dismissed with prejudice, and surrendered the notes and released the mortgage. It was agreed that the Brewing Company was indebted to the Trust Company in the sum of $63,650; $50,000 principal, and the remainder delinquent interest, and taxes and insurance on the property paid by the Trust Company. The Trust Company gave the Brewing Company an eighteen months option to repurchase the property for the amount of the indebtedness, the parties agreeing to cooperate in the endeavor to find a purchaser for the property during the option period (Tr., 13-19). The Brewing Company continued in possession of the premises during the option period, and seemingly made considerable effort to find a purchaser for the property, as a whole or in parcels. At the monthly meetings of the directors of the Brewing Company during that period, Schade reported the efforts being made to sell the property and the prospects for making a sale (Tr., 59-61). No sale could be made, however, and at the expiration

of the option period, 1st July, 1919, the Trust Company took possession of the property (Tr., 63-64). On 25th August, 1919, the Trust Company made an offer to all the shareholders of the Brewing Company to give them an interest in the property, proportionate to their shareholdings in the Brewing Company, if they would pay a proportionate share of the Brewing Company's indebtedness to the Trust Company; in other words, the Trust Company offered to convey the property of the Brewing Company to its shareholders if they would pay the incumbrance on it, or if all the shareholders would not come in, to give to any shareholder a part interest in the property who would pay a proportionate part of the incumbrance (Tr., 92-94, 165-169). Seven or eight of the shareholders accepted the offer (Tr., 94). Plaintiff, who is a niece of B. Schade and bought her stock from him (Tr., 80), was not one of these, being under the impression, as the waging of this suit evidences, that a court of equity would give the property back to the shareholders freed from the incumbrance upon it, leaving the debtor to hold the sack. The particular court to which she appealed, however, considered her complaint to be "entirely devoid of equity," and so dismissed her suit (Tr., 43-47).

ARGUMENT.

Counsel have presented appellants' case by attacks upon segregated parts of the chain of reasoning by which Judge Rudkin reached the conclusion that the suit was devoid of equity. It will be more conductive to clarity, we think, to segregate and discuss the ultimate points which may be made against and in support of that conclusion, and we shall pursue that course in presenting the appellee's case.

The points which appellants make for reversal are these: (a) That the conveyance of all the property of the Brewing Company to the Trust Company was *ultra vires* the Brewing Company; (b) That the conveyance was not authorized by the board of directors of the Brewing Company; (c) That the conveyance was fraudulent, in that the officers of the Brewing Company personally profited by the transaction. After discussing those points we shall urge upon the Court that, albeit those points were well taken, nevertheless the suit is not maintainable because appellants do not offer to do equity, but on the contrary are asking the aid of a court of equity to do inequity.

We premise our discussion of the questions involved by suggesting that they are to be decided by reference to the local law of Washington. The Brewing Company is a Washington corporation, and in determining whether, in making the conveyance

assailed, it acted in conformity to or defiance of the Washington statutes governing the action of Washington corporations, the decisions of the Washington courts will control the Federal courts. *Smith v. Kernochan*, 7 How. 198; *Williams v. Gaylord*, 186 U. S. 157; *Equitable L. Assur. Soc. v. Brown*, 213 U. S. 25; *Fifth Ave. Coach Co. v. New York*, 221 U. S. 467. Furthermore, the transaction is of a purely local character, occurring wholly in Washington and between citizens of that State, and in such case the Federal courts will adopt the rule of the State courts upon questions of law which are of a general nature; *e. g.*, as to what is essential to the maintenance of an action for rescission. *Sim v. Edenborn*, 242 U. S. 131. This Court has always alhered to the rule that there ought to be but one rule of law within the State, administered in the Federal as well as the State courts, and that upon matters of general law it would follow the rule adopted by the State courts, unless coerced by controlling decisions to adopt a different rule. *American Surety Co. v. Bellingham Nat. Bank*, 254 Fed. 54.

We do not make the suggestion in anticipation of a conflict between Federal and State decisions upon the questions involved, for we find no conflict, but entire concordance. It is made in explanation of the fact that we have not looked beyond the Washington and Federal reports for authority to sustain our positions.

I.

(a) *Ultra Vires.*

The powers of the Brewing Company, as stated in its original articles of incorporation, were limited, being confined to the manufacture and sale of beer, and the acquisition of such real and personal property as was necessary for the carrying on of such business (Tr., 4-5). In 1907 the articles were amended so as to increase the corporate powers. While the manufacture and sale of beer remained the chief purpose of the corporate existence, power was conferred upon the corporation to "purchase, acquire, * * * mortgage, sell and convey breweries, malt houses, bottling works," etc., and to "purchase, * * * mortgage, sell and convey real and personal property for any purpose which the corporation may deem expedient," etc. (Tr., 81). Under the amended articles there can be no doubt of the power of the Brewing Company to sell all its property. In *Pitcher v. Lone Pine Surprise Co.*, 39 Wash. 608, the sale by a mining company of all its mines was attacked by a dissenting shareholder upon the ground, *inter alia,* that it was *ultra vires* the company. The purposes for which the company was formed, as stated in its articles of incorporation, were to "work, operate, buy, sell, * * * hold and deal in mines." Referring to these powers, the Court said: "The trustees, therefore, had the power to sell these mines." The question was more concretely presented in *Lange v. Reser-*

vation Min. Co., 48 Wash. 167. There a shareholder brought suit to enjoin a mining company from selling its property, claiming that "neither the trustees, nor a majority of the stockholders of a corporation, have power, against the objection of minority stockholders, to sell or otherwise dispose of the entire property of the corporation," unless such sale was necessary to pay debts, prevent losses in a losing business, etc. The corporation was given power, by its articles of incorporation, to "buy, sell, * * * and deal in mines." Admitting the soundness, in an appropriate case, of the rule contended for by the plaintiff, but denying its applicability to the instant case, the Court said:

> "It is a question of power in the board of trustees. And this power exists, we think, both by virtue of the articles of incorporation, and the general law conferring the management and control of the corporate business on the board of trustees. Pitcher v. Lone Pine-Surprise Consol. Min. Co., 39 Wash. 608, 81 Pac. 1047."

The final word of the Washington Supreme Court upon this subject is found in *Logie v. Mother Lode Mines Co.,* 106 Wash. 208, 216. There is was said:

> "Under the power granted by Rem. Code, §3683, especially subdivisions 3 and 7 thereof, a corporation, whose objects and purposes are declared by its articles of incorporation to be, among other things, to purchase and acquire real and personal property and sell and alienate the same, in whole or in part, freely and to the same extent as any person, actual or artificial, having similar dominion over property may lawfully do, obvi-

> ously has the power to lawfully dispose of substantially all, or in fact all, of its property. That is one of its objects. The power to sell all or part of its property is coextensive with the power to acquire by purchase or otherwise. This court has repeatedly held that, where the right and purpose to sell is among the objects expressed by its articles, a corporation may sell—that is, has the power to sell—all of its property, notwithstanding the dissent of minority stockholders."

This Court, upon substantially similar facts to those appearing in the above cited cases, has reached the same conclusion as the Supreme Court of Washington. *Geddes v. Anaconda Min. Co.*, 245 Fed. 225. And such, unquestionably, is the universal rule. 14a Corpus Juris, 541, §2416.

It is feebly contended that the Brewing Company could not amend its articles of incorporation without the unanimous consent of its shareholders. If that were admitted the appellants' cause would not be advanced. When the amended articles were offered in evidence it was not objected that the amendment had not been duly authorized, and it does not appear but that the amendment was assented to by all the stockholders (Tr., 81). Obviously this Court will not presume that the amendment was not properly adopted, in order that it may thereby impute error.

But the contention is so utterly unsound as matter of law that it is surprising it is made. The sections of Remington & Ballinger's Code to which counsel refer have not the slightest relevancy to the subject of amendment of articles of incorporation. The con-

stitution of Washington, in effect, of course, when the Brewing Company was incorporated, provides that:

> "Corporations may be formed under general laws, but shall not be created by special acts. All laws relating to corporations may be altered, amended, or repealed by the legislature at any time, and all corporations doing business in this state may, as to such business, be regulated, limited, or restrained by law."
>
> Article XII, §1, Remington's 1915 Code.

The section of the statute which provides for articles of incorporation, their contents and amendment, provides that:

> "Amendments may be made to the articles of incorporation by a majority vote of its trustees and the vote or written assent of two-thirds of the capital stock of such corporation. * * * The president and secretary of said corporation shall certify said amendments in triplicate under the seal of said corporation to be correct and file and keep the same as in the case of original articles and from the time of filing said amendments such corporation shall have the same powers and it and the stockholders thereof shall be subject to the same liabilities as if such amendments had been embraced in the original articles of incorporation."
>
> Remington & Ballinger's Code, §3679, Remington's 1915 Code, §3679.

In the face of these constitutional and statutory provisions we are surprised that counsel should even suggest that the articles of incorporation of a Washington corporation cannot be amended without the

unanimous consent of its shareholders. True, authorities may be found holding that under a reserved power of amendment "no complete and radical change, creating, in substance, a new corporation, could be made against the opposition of any shareholder." 1 Machen, Corporations, §147. But here no radical change was made. The primary, indeed, the sole business, of the Brewing Company remained the manufacture and sale of beer, and the only effect of the amendment was to enlarge its powers in respect of the acquisition and disposal of property used in connection with that business. Manifestly such an amendment was permissible under the constitutional and statutory provisions of Washington. 1 Machen, Corporations, §147; 2 Cook, Corporations (6th ed.), pp. 1322-1325. This Court has held that under provisions like those of the Washington constitution, it is permissible for the State to authorize corporations previously formed to dispose of all their property. *Geddes v. Anaconda etc Co.,* 245 Fed. 225. And such is the universal rule. *Allen v. Ajax Min. Co.,* (Mont.), 77 Pac. 47.

Moreover, this amendment was made in 1907. For thirteen years the amendment appeared upon the corporate records and the public records of the State (amendments to articles of incorporation are required to be kept as a part of the corporate records and filed in the office of the Secretary of State and of the County Auditor of the county where the corporate place of business is located, Remington's 1915 Code,

§3679), as the organic law of the company. During that time no shareholder of the Brewing Company took any step to nullify the amendment or made any objection to it. It must be presumed that the Trust Company dealt with the Brewing Company in reliance upon the amendment. It is clear that shareholders will not now be heard to say, in order to destroy the rights of a corporate creditor, that the amendment was not properly authorized. 2 Cook, Corporations (6th ed.), §503; 1 Machen, Corporations, §157.

However, the conveyance is unimpeachable although the amendment of the articles of incorporation be disregarded, and the Brewing Company be considered to possess no powers except those stated in the original articles. It was organized for and engaged in the transaction of business. It had, of course, power to contract indebtedness for the prosecution of its business. Under the Washington statute it also had power, regardless of any expression in its articles of incorporation, to "purchase, hold, mortgage, sell and convey real and personal property." Remington & Ballinger's Code, §3683. Remington's 1915 Code, §3683. This statutory provision was considered by the Washington Supreme Court in *Klosterman v. Mason County Ry.*, 8 Wash. 281. A railroad company borrowed money for the purposes of its corporate business, and mortgaged its property to secure the indebtedness. Being unable to pay the debt it conveyed the mortgaged property, which was all the property it owned, in satisfaction of the mort-

gage. Unsecured creditors of the corporation attacked the conveyance, claiming it to be in contravention of the constitution of Washington and of the trust fund theory of corporate property which is a dominant feature of the corporate law of Washington. The Supreme Court sustained the conveyance. Referring to the statutory language above quoted, it said:

> "From this comprehensive provision it will be seen that the appellant corporation had a right, in the proper conduct of its business, to mortgage its property to secure its debts. And this being so, it had a right to sell, in good faith, any or all of its property in payment of its mortgage liens. 2 Rorer, Railroads, p. 880; and see Railroad Co. v. Howard, 7 Wall. 392; Warfield v. Marshall County Canning Co., 72 Iowa 666 (34 N. W. 467). In the absence of legislative restrictions, or some limitation arising from its nature, a corporation may dispose of any property it has a right to acquire, in the same manner as an individual. Pierce, Railroads, 503. By legislative permission it may even dispose of its franchise. See Willamette Mfg. Co. v. Bank of British Columbia, 119 U. S. 191 (7 Sup. Ct. 187).
> * * *
>
> The learned counsel for the respondent and the intervenors insist that, by virtue of the above cited provision of the constitution, the property in question is still subject to the claim of the respondent. But we are not of that opinion. That provision declares, in effect, that, if a corporation shall lease or alienate its franchise, neither the franchise nor the property held thereunder shall thereby be relieved from liabilities contracted or incurred in the operation, use or enjoyment of such franchise, or any of its privileges. This is but a declaration of what the

> courts have generally held to be the law, irrespective of constitutional limitations or provisions. Chicago etc. Ry Co. v. Chicago Third Nat. Bank, 134 U. S. 376 (10 Sup. Ct. 550). But we do not think that there is anything in the law or this provision of the constitution which inhibits a corporation from voluntarily transferring property for the payment of debts for which the property so transferred is legally bound."

The case at bar is ruled by the cited case. The indebtedness of the Brewing Company to the Trust Company was a just debt, arising from a loan of money for the purposes of the corporate business. No question is made concerning the validity of the mortgage given to secure the debt. The sole claim is that it was beyond the power of the Brewing Company to convey the mortgaged property in satisfaction of the debt. Precisely that contention was made in the Klosterman Case, and the decision here must follow the decision there.

But disregard, if you please, the antecedent mortgage. The Brewing Company was in such a financial condition when the conveyance was made as to preclude any shareholder from denying its power to convey its property in payment of its debts. And this, mark you, without consideration of the provisions of its articles of incorporation, and without regard to whether the creditor to whom the conveyance was made had or had not a lien upon the property conveyed.

It has never been questioned in any court that a

private business corporation may, without the consent of its shareholders, sell all its property for the purpose of paying its debts, especially when it is in an embarrassed condition.

> "There can be no doubt that a corporation has the power to convey or transfer any part or all of its property when necessary to pay debts lawfully contracted by it. And for this purpose it has the same power as a natural person to make an assignment in trust for the benefit of its creditors, provided there is no charter or statutory restriction in the way."
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> 2 Fletcher, Cyclopedia Corporations, §1191.

> "A purely private business corporation, like a manufacturing or trading company, which is not given the right of eminent domain, and which owes no special duties to the public, may certainly sell and convey absolutely the whole of its property, when the exigencies of its business require it to do so, or when the circumstances are such that it can no longer profitably continue its business, without regard to whether minority stockholders consent or object, provided the transaction is not in fraud of the rights of creditors, or in violation of charter or statutory restrictions."
>
> *Ibid,* §1207.

> "At common law neither the directors nor a majority of the stockholders has power to sell all the property of a going, prosperous corporation, able to achieve the objects of its creation, as against the dissent of a single stockholder. Where, however, the corporation is insolvent or in failing circumstances, and the business can no longer be carried on profitably and advantageously, such a sale may be made, and minority stockholders cannot object thereto in the absence of fraud."
>
> 14 Corpus Juris, 866.

In *Geddes v. Anaconda Min. Co.*, 245 Fed. 225, 233, this Court quoted approvingly from Judge Thompson the following rules governing the right of a corporation to dispose of all its property:

> "Where the corporation is in failing circumstances, or is in fact insolvent, the directors and managing officers may dispose of all the property, or make an assignment of all the corporate property for the benefit of creditors. * * *
>
> The majority stockholders, even as against the protest of the minority, may dispose of all the property when the corporate business has become unprofitable, and where it would be ruinous to the corporation and the stockholders to continue the business, or where there are insufficient funds to continue the business and no money with which to pay existing indebtedness, or when the corporation is in failing circumstances, or is in fact insolvent."

While the Supreme Court of the State has never had occasion to rest the power of a private corporation to sell all its property solely upon its insolvent or embarrassed condition, yet in *Lange v. Reservation Min. Co.*, 48 Wash. 167, 168, it was assumed to be settled law that a corporation had power, over the objection of minority shareholders, to sell all its property for such causes "as the payment of legitimate debts, the prevention of further losses from a losing business, or such like causes." There can be no doubt of its agreement with the settled rules heretofore stated.

Now the condition of the Brewing Company when the conveyance was made, in 1918, was deplorable;

hopeless in fact. It had no other business but the manufacture and sale of beer. Its entire capital was invested in that business. It had no property but a brewery situated in Washington. That State became emphatically "dry" on 1st January, 1916. The neighboring States of Idaho and Oregon were in the same condition. In 1917 Congress had adopted a joint resolution proposing the Eighteenth Amendment, and no one doubted that it would be adopted. For a short time after Washington went dry the Brewing Company ran a soft drink establishment on a very small scale, but the business never paid and was soon abandoned. From thence on it did no business, had no income, could not pay its taxes, and had not "a dollar's worth of money" (Tr., 63-64). The principal of its debt to the Trust Company was overdue, interest on the debt was unpaid, and it had defaulted in the payment of taxes and insurance on the property, which it had agreed in the mortgage to keep up. In January, 1918, when the conveyance was made, the interest on the debt amounted to $6,000, delinquent taxes, on account of which tax certificates had been issued, amounted to over $5,600, and unpaid premiums for insurance amounted to over $700 (Tr., 16.) The conveyance was made, says Stritesky, because the company "Couldn't pay the mortgage and there wasn't anything else to do" (Tr., 64). For long before that time it had been recognized by the Brewing Company and Mr. Geraghty, its then counsel, that it could not pay the debt, and that its sole hope was to stave off fore-

closure as long as possible; the plan of avoiding foreclosure by conveying the property with a stipulation for buying it back after a time having long been in mind (Tr., 96-98). Mr. Schade was too ill to appear in court (Tr., 80), but the reports which he made to the board of directors at its monthly meetings during the period from the time of the conveyance to the expiration of the option to repurchase period, show that the officers of the company had no hope of saving anything from the wreckage unless the property could be sold piecemeal (Tr., 59-61). That the business of the Brewing Company was totally destroyed by the prohibition wave which has swept the country, and that it was hopelessly insolvent, had no hope for paying its indebtedness, and would have lost its property by tax foreclosure or possible destruction by fire, uninsured, but for the intervention of the Trust Company, are facts so patent that it would be presumptuous to dilate upon them. And that such conditions relieve the conveyance from the imputation of *ultra vires* which might otherwise be cast upon it is too clear to require more than suggestion.

Finally, under the settled law governing the transactions of Washington corporations, the Brewing Company is estopped to say the conveyance was *ultra vires*. From the time of *Tootle v. Bank,* 6 Wash. 181, to *Flanagan v. American Min. Co.,* 108 Wash. 569, it has been the settled doctrine of the Supreme Court of Washington that a corporation which has enjoyed the benefit of its *ultra vires* act could not repudiate

it. Nor is the doctrine of estoppel limited to cases where the corporation has received benefit from the *ultra vires act*. It is equally invocable where it does not appear that direct benefit has accrued to the corporation, but it does appear that for its own purposes the corporation did the act, and that in reliance upon its action the other party has acted to his injury. In such case the corporation may not repudiate its action merely on the ground that it exceeded its charter powers. It will only be permitted to do so "where the transaction is prohibited, illegal, or immoral." *United States F. & G. Co. v. Cascade Const. Co.,* 106 Wash. 478. To the same effect are *Creditors Claim etc. Co. v. Northwest L. & T. Co.,* 81 Wash. 247, and *Moore v. American Sav. Bank,* 111 Wash. 148. Those decisions are controlling here, being a part of the local law governing the transactions of Washington corporations. *Eastern Bldg. & Loan Ass'n v. Ebaugh,* 185 U. S. 114; *Lindauer v. Compania Polonias,* 247 Fed. 428. They are, furthermore, thoroughly in harmony with the decisions of this Court. *United States Sav. & L. Assn. v. Convent of St. Rose,* 133 Fed. 354; *Kellogg-Mackay Co. v. Havre Hotel Co.,* 119 Fed. 727.

The Brewing Company has received benefits from the conveyance in that in reliance upon it the Trust Company took up an outstanding tax certificate against its property of $5,550, since it was made has paid about $8,000 for taxes and insurance on the property, and has surrendered the notes and released the mortgage

(Tr., 92-96). The Trust Company has been injured by the dismissal of the foreclosure suit, the release of its notes and security, and the cost of keeping up an unproductive property. Its expenditures have run into thousands of dollars, and it has received not one cent of income from the property (Tr., 92). Clearly here is ample ground for estoppel against the Brewing Company, and equally clearly the estoppel runs against the shareholders as it would against the corporation. They sue in its right; what concludes it concludes them; if for any cause it could not maintain the suit they cannot. 6 Fletcher, Cyclopedia Corporations, §4061; Machen, Corporations, §1183; 14 Corpus Juris, 929, §1446. As said by the Court of Appeals of New York:

> "A plaintiff who asserts a derivative cause of action must establish the existence of a cause of action in the party whose rights are sought to be enforced. A cause of action cannot be derived from a source in which it does not exist."
>
> *Waters v. Horace Waters Co.*, 94 N. E. 602.

Turning to the appellants' positions and authorities, it will be observed that the point upon which they most insist is that by the conveyance of all its property the Brewing Company was disabled from transacting the business for which it was organized; that it therefore amounted to a dissolution of the corporation; and that as the Washington statute has provided a method by which corporations may be dissolved, the adoption of any other method is *ultra vires*.

If it were conceded that the conveyance did, in effect, dissolve the corporation, it would by no means follow that it was therefore illegal. There is necessarily embraced in the powers of every corporation organized for the transaction of business for profit, the power to incur debts in the prosecution of such business, and the power to use its corporate property for the payment of such debts. Indeed, under the law of Washington it is obligatory upon such a corporation to use its property to pay its debts, for its property is a trust fund for the benefit of its creditors. *Thompson v. Lbr. Co.,* 4 Wash. 600; *Conover v. Hull,* 10 Wash. 673; *Compton v. Schwabacher,* 15 Wash. 306. So it may make a common law assignment for the benefit of its creditors, and a shareholder may not complain, since it is "the settled rule * * * that the assets of a corporation constitute a trust fund for the payment of all its creditors, and every stockholder is conclusively charged with notice of the trust character which it attaches to the capital stock." *McKay v. Elwood,* 12 Wash. 579, 584. Therefore a Washington corporation, while solvent, may mortgage all its property to secure the payment of its debts, and no valid objection can be made to the mortgage because through its operation the corporation was stripped of all its property and prevented from prosecuting the business for which it was organized. *Klosterman v. Mason County Ry,* 8 Wash. 281. It is evident, therefore, that the Brewing Company had power to mortgage all its property to secure the

payment of its debt to the Trust Company. As neither the Brewing Company nor its shareholders could have defended a foreclosure of the mortgage on the ground that a decree of foreclosure and sale would amount to a dissolution of the corporation, on what theory can its shareholders be permitted to set aside a conveyance of the mortgaged property, made in satisfaction of the mortgage debt, because it would amount to a dissolution? The answer is found in the Klosterman Case: There is no such theory. The Supreme Court there said of the corporate defendant: "It had a right to sell, in good faith, any or all of its property in payment of its mortgage liens." It is clear, therefore, that it cannot be validly objected to the conveyance by a Washington corporation of all its property in satisfaction of its debts, that it was thereby disabled from the further transaction of business, and was, in effect, thereby dissolved.

Moreover, if in any case the conveyance by a corporation of all its property in payment of its debts could be objected to by a shareholder on the ground that the corporation was thereby disabled from pursuing its corporate objects, that objection cannot be made here. It was the wave of prohibition legislation sweeping the United States, more particularly the Washington prohibitory law, which disabled the Brewing Company from further pursuit of its business. It had no property but a brewing plant. It endeavored to put that plant to the only lawful use to which it could be put, the manufacture of soft

drinks, but the business was unprofitable and it was forced to abandon it. Counsel suggests that it could have renewed its brewing business in one of the other states in which it was authorized to do business. Idaho and Oregon were already dry. The Eighteenth Amendment had been submitted by Congress, and there was no reasonable doubt that it would be approved in a sufficient number of states to secure its adoption. Even if it would have been other than idiocy for the Brewing Company to think of engaging in the brewing business in any other state under such conditions, it had not the means to do so. To acquire realty, construct appropriate buildings, and move its brewing machinery to a location in another state, would have required an expenditure of thousands of dollars, and it had not a cent. Moreover, the mortgage it had given, and the lien which, under the trust fund theory of the Washington law, corporate creditors have upon corporate property, would have prevented its migration with any of its property, save with the consent of the Trust Company. Plainly, then, it was the law, not the conveyance of its corporate property, that disabled the Brewing Company from pursuing its corporate business. We suppose it will not be contended that the enactment of the prohibitory law dissolved the Brewing Company, and if it could not have that effect, the conveyance of the corporate property, which was necessitated by the conditions which the law created, could have no such effect.

However, the notion that the mere conveyance by a

corporation of all its property disabled it from performance of its corporate functions, and therefore amounted to its dissolution, is exploded in this jurisdiction. That notion was the basis for the plaintiff's contention in *Lange v. Reservation Min. Co.*, 48 Wash. 167. The Supreme Court held it fallacious, saying that "the corporation will be in as good a condition to proceed with the objects it was formed to promote, after this sale, as it was before." That case was followed in *Smith v. Flathead R. Coal Co.*, 66 Wash. 408, where it was held that a sale of all the defendant's property was not a dissolution of it. The same question was before this Court in *Geddes v. Anaconda Min. Co.*, 245 Fed. 225, and it held that a transfer of all its property did not dissolve a corporation; that property is not essential to corporate existence, and that there was nothing in a sale of all the corporate property which would prevent the corporation from proceeding with the corporate business and acquiring other property. The soundness of those decisions is seen when applied to the facts of the case at bar. The Brewing Company used its property to pay its debts. It was thus left propertyless and, in compensation, debtless. Manifestly the transaction by which it parted with its property and paid its debts did not, as matter of law, disable it from acquiring other property and continuing its corporate business. Its disability was caused by the prohibition legislation which was sweeping, and shortly swept, the country. That legislation rendered its business

unlawful, stripped it of all income and resources, and so impaired the value of its property that it could not sell the property in the market for sufficient to pay its debts. Nevertheless (adapting the language used in the Lange Case) the Brewing Company was "in as good condition to proceed with the objects it was formed to promote, after the conveyance, as it was before," for at neither time could it proceed. The law forbade it at one time as it did at the other.

Counsel lay great stress upon the cases of *Parsons v. Tacoma Smelting Co.,* 25 Wash. 492, and *Theis v. Spokane Gas Co.,* 34 Wash. 23. Those cases are not even remotely relevant. In the Parsons Case the corporation was engaged in a lawful business, was a going concern, and, while its business had not been very profitable, only a small part of its capital stock had been paid in, and if its officers had done their duty and compelled payment of the delinquent subscriptions, it would have had ample funds for the prosecution of its business. The purpose of the lease, the Supreme Court considered, was not to "keep the corporation a going concern, and enable it to perform the objects of its organization," but to relieve the delinquent shareholders from the necessity for paying for their stock, to obtain control of the stock, and to organize a new corporation which should include the elect and exclude the reprobate of the old corporation (pp. 500-501). While the Court held that these things could not be done over the objection

of minority shareholders, it observed, in distinguishing the cases upon which the corporation relied, that "an insolvent corporation may make an assignment for the benefit of its creditors against the will of a non-consenting stockholder, and probably any appropriate proceedings in equity might be taken to relieve a failing corporation by such disposition of its property as should be equitable" (p. 506).

The Theis Case involved a pure hold-up, thinly disguised under legal forms. The gas company, defendant there, was a highly prosperous concern. A syndicate of eastern bond buyers desired to get all its stock, and did buy all but Theis' eight shares. When he declined to sell they began disincorporation proceedings under the Washington statute, sold the property at public auction to a representative of the syndicate, and he immediately transferred it to a new corporation, formed by the syndicate, which continued, uninterrupted, the business of the former corporation. It was openly admitted that the disincorporation proceeding was a mere form, the sole purpose of which was to get rid of the single shareholder who would not sell his stock. Of course no court would permit that to be accomplished by mere mumming which the law forbids to be done straightforwardly. How the case can be supposed to be even remotely relevant to the questions here involved passes comprehension.

To dispose of the two cases as authority in the

case at bar, it needs but to be remarked that they were strongly urged upon the Supreme Court as authority for upsetting the sales involved in *Lange v. Reservation Min. Co.,* 48 Wash. 167; *Smith v. Flathead R. Coal Co.,* 66 Wash. 408; and *Logie v. Mother Lode Min. Co.,* 106 Wash. 208. In each of these cases they were put aside as utterly inapplicable.

We here wish to call attention to misquotations, inadvertent, we are confident, on pages 44 and 54 of the appellants' brief. In the report of the Theis Case, 34 Wash. 24, the points made and authorities cited by the respective counsel in that case are given. Among other points made by the plaintiff's counsel appears this: "The sale of its entire property is a dissolution without compliance with the statute." This language is changed to read: "The sale of the entire property of a corporation without compliance with the statute is a dissolution," and as so changed appears upon pages 44 and 54 of the appellants' brief in the case at bar, under the guise of a quotation from the opinion of the Court in the Theis Case. This was error. No such language, nor anything approaching it, was used, nor any such principle, nor anything approaching it, declared, in the Court's opinion. On the contrary, the sale there involved was set aside solely on the ground that while it was made under the guise of a statutory disincorporation and dissolution, the proceeding was a mere farce, no dissolution was intended or had, and the statutory form was resorted to as a disguise to the perpetration of a

fraud upon a shareholder who would not sell his shares.

Misleading, too, is the use made on page 44 of appellants' brief of the quotation from *Andrews v. National Foundry*, 76 Fed. 171. The quotation is from an opinion by the Circuit Court of Appeals for the Seventh Circuit, and relates to a decision by the Supreme Court of Wisconsin construing a Wisconsin lien statute. It is utterly foreign to the question under discussion, yet it is given the guise of an approval by a Federal court of the Theis Case as a decision controlling it, or rather, an approval of the contention of counsel in the Theis Case as though it were a decision of the Supreme Court of Washington which controlled it.

Bitter complaint is made that Judge Rudkin placed undue emphasis on the right of the Trust Company to have its debt paid from the property of the Brewing Company. It is insisted that the shareholders of the Brewing Company have a paramount right to demand that all its property shall not be taken for the satisfaction of its debts, save through the medium of the statutory disincorporation proceedings. And this holds good, it is said, although the corporation had ceased to be a going concern, with no possibility of a renewal of its business, owed debts that it could not pay, or was hopelessly insolvent.

It is difficult to characterize, courteously, such a contention. A shareholder in a moribund or an

insolvent corporation, or one which is unable to pay its debts save through the application of its propetry thereto, is in no position to prate about his paramount rights, or to complain that a court to which he resorts for relief against a creditor treats the creditor's right to payment as of prime importance. Apart from that consideration, the disincorporation statute to which counsel refer, Rem. & Bal. Code, §3708, Rem. 1915 Code, §3708, is not a medium for the enforcement of payment of corporate debts. It does not provide for a proceeding *in invitum.* The corporation must voluntarily petition for disincorporation. No method is provided for seizure of the corporate property to satisfy the corporate debts. On the contrary, it provides that there shall be no dissolution until all claims against the corporation are discharged. Evidently here is no medium for the collection of debts.

But on general principles it is idle to contend that if a creditor would take the property of a corporation for the satisfaction of his debt, he must resort to dissolution proceedings. All the means which are available for the collection of a debt from an individual are available for the collection of a debt from a private corporation. An execution will run against it. 6 Thompson, Corporations (1st ed.), §7847. Save where their use conflicts with the trust fund theory of corporate property, writs of attachment may be levied upon its property. *Washington Liquor Co. v. Alladio Cafe Co.,* 28 Wash. 176; *State ex rel*

Krisch v. Superior Court, 36 Wash. 91. It may make a common law assignment for the benefit of its creditors. *McKay v. Elwood,* 12 Wash. 579; *Cerf v. Wallace,* 14 Wash. 249. A creditor's bill may be brought against it, and a receiver appointed for the purpose of conserving and disposing of its property for the benefit of its creditors, either because it has made conveyances for the purpose of hindering, delaying and defrauding its creditors, *Sligh v. Shelton Ry. Co.,* 20 Wash. 16, or because it is insolvent. *Davis v. Edwards,* 41 Wash. 480; *Barnard Mfg. Co. v. Ralston Mill Co.,* 71 Wash. 659. And it may give a mortgage to secure the payment of its indebtedness, and, if unable to pay the debt, may convey the mortgaged property, although it is all the property which it owns, in payment of the debt. *Klosterman v. Mason County Ry.,* 8 Wash. 281.

In the light of these authorities, and of the accepted rule stated by the text writers hereinbefore cited, namely, that a corporation has unquestionable power to sell all its property, albeit minority shareholders object, for the purpose of paying its debts, or when business exigencies demand, we cannot think counsel's present contention other than puerile.

Oregon Ry. & Nav. Co. v. Oregonian Ry. Co., 130 U. S. 1, is cited with an apparent air of confidence. It is not even remotely relevant to the question here involved. There the lessee of a railway system declined to perform the lease, invoking the familiar

rule that a public service corporation cannot, without express legislative permission, transfer all its property, and thereby disable itself from the discharge of its duties to the public. Counsel who were endeavoring to sustain the lease did not question that rule, but sought to discover the necessary legislative permission in sundry statutory provisions, among others, the statutory right to disincorporate upon complying with certain requirements. The Court held that the statutory provision for a *bona fide* dissolution and termination of the corporate existence was not sufficiently elastic to include a grant to a going concern, which had not suspended its corporate existence and had no intention of doing so, to suspend its operations until it chose to resume them. We are unable to understand how what is said *arguendo* in that behalf, which is what appellants have quoted, can be deemed applicable to the case of a purely private corporation, which is not a going concern, whose business has been made unlawful, and which, being otherwise unable to pay its debts, has conveyed its property in payment thereof.

(b) *Authorization of Conveyance.*

The conveyance which is attacked was executed on behalf of the Brewing Company by Schade and Stritesky, its president and secretary, respectively. Its execution was never formally authorized by the board of directors of the Brewing Company, and it is urged that it was therefore ineffectual to convey title.

Our first answer to that contention is that the

execution of the deed was ratified by the board, and it is therefore immaterial that there was no precedent authorization, for "subsequent ratification * * * is equivalent to previous authority." *Graham v. Boston etc. Ry.*, 118 U. S. 161, 171. That, of course, is merely a particular application of the general rule of agency, that "every ratification relates back and is equivalent to prior authority." 2 Corpus Juris, 516. For illustration of subsequent ratification by corporate authorities being held equivalent to previous authority, see *Kirwin v. Washington Match Co.*, 37 Wash. 285; *Western Timber Co. v. Kalama etc. Co.*, 42 Wash. 620, and *Indianapolis Rolling Mill. v. St. Louis etc. Ry. Co.*, 120 U. S. 256.

The acts of ratification were these: The board of directors of the Brewing Company consisted of B. Schade, Sophia Schade, his wife, and L. R. Stritesky. It appears to have held monthly meetings, and the secretary, Stritesky, read from the minutes of those meetings everything which related to the transaction involved. At the meeting in October, 1917, Schade called the attention of the board to the foreclosure proceeding begun by the Trust Company, stated that he had addressed a letter to the shareholders requesting "an expression of opinion from them in this crisis and means of meeting it," and "ways and means" for meeting the turn in the company's affairs were discussed (Tr., 58). In the letter above referred to, the shareholders were advised that the Trust Company was pressing for payment of the mortgage,

and that "quick action" in the matter of paying the mortgage was necessary, else the mortgaged property would be sold at forced sale, and at a great sacrifice. The opinion of the shareholders as to what should be done was asked, and the letter closed: "Perhaps it would be for the best interests of all concerned to sell outright. This is the plan that I look most favorably to at present." (Tr., 170-171.)

Returning to the minutes of the board meetings, in November, 1917, the advisability of contesting the foreclosure proceedings was discussed, and it was decided to get legal advice (Tr., 57-58). At the December meeting, it was reported that counsel had been secured (Tr., 58). At the February meeting, 1918, at which all the directors were present, the attention of the directors was directed to the foreclosure proceedings, which, the minutes recite, "if carried through the courts would have caused unnecessary expense and no benefits realized." The board was advised that because of this the mortgaged property had been conveyed to the Trust Company, which had given an option to repurchase, expiring in July, 1919, for the amount of the debt. The amount was stated in the minutes, and reference was made to the volume and page of the public record where the agreement was recorded (Tr., 56-57). At every meeting of the board thereafter, the efforts to dispose of the property and their ill success were reported, but no further reference was made to the conveyance until at the July, 1919, meeting, when it was stated

that the property of the company was to pass into the hands of the Trust Company on 1st July, but that it had made no move to take possession (Tr., 59-61). Neither at the meeting when the conveyance was reported to the board, nor at any subsequent meeting, did the board or any member of it express disapproval of the conveyance.

Such a course, it is clear, was an implied ratification of the conveyance by the board, and the implied ratification was as effectual as an express ratification would have been. The Brewing Company was in desperate financial straits. A foreclosure suit, threatening the loss of its entire property, and with a possible deficiency judgment over against the corporation, was pending. It had not a dollar to meet the claim, and the shareholders had been appealed to, evidently without success. Moreover, taxes were delinquent on the property, and a delinquency certificate had been issued against it, which bore interest at the rate of 15% per annum (Tr., 16, 61, 64; Rem. & Bal. Code, §9253). It was certain that the company was going to lose the property, very quickly and in a most ruinously expensive fashion, unless it made an immediate compromise with its creditor. It made the compromise. In consideration of the conveyance the Trust Company took care of the taxes and insurance, dismissed the pending foreclosure suit, cancelled the debt and released the mortgage, allowed (in substance) an additional six months redemption period, and left the company in possession during the

eighteen months period allowed for redemption. If the board of directors desired to object to the conveyance as unauthorized, it is manifest that under such circumstances it was necessary that it act with the utmost promptness, and its mere silence, its mere failure to act, was a ratification.

Very pat in that connection is *Indianapolis Rolling Mill v. St. Louis etc. Ry.,* 120 U. S. 256. We quote from its syllabus:

> "A board of directors of a corporation to whom the president of the company communicates his execution of a contract on the part of the corporation, which is within its corporate powers but unauthorized by the board, will be presumed to ratify his act unless it dissents within a reasonable time; and a delay in the disaffirmance of six months after knowledge of the act is an unreasonable delay."

In *Pittsburg etc. Ry. Co. v. Keokuk etc. Bridge Co.*, 131 U. S. 371, 381, is was said:

> "When the president of a corporation executes, in its behalf, and within the scope of its charter, a contract which requires the concurrence of the board of directors, and the board, knowing that he has done so, does not dissent within a reasonable time, it will be presumed to have ratified his act."

For cases in this Court of ratification through failure to object to an unauthorized act within a reasonable time, see *West Side Irr. Co. v. United States,* 246 Fed. 212, and *Mutual Oil Co. v. Hills,* 248 Fed. 257. The rule is the same in the State court. *Blair v. Met.*

Sav. Bank, 27 Wash. 192; *Kirwin v. Washington Match Co.,* 37 Wash. 285; *Western Timber Co. v. Kalama Lbr. Co.,* 42 Wash. 620.

Our second answer to the contention is that the objection that the president and secretary were not formally authorized by the board to execute the conveyance is a purely technical one, to which a court of equity ought not to give heed. A valid mortgage, given to secure a valid debt, incumbered the property. The corporation was without means to pay the debt and save the property, and the shareholders, although informed of the situation and the necessity for taking "quick action" if the property was to be saved, had done nothing. In this strait the executive officers of the Brewing Company conveyed the property in satisfaction of the debt. By so doing they secured concessions not otherwise obtainable, and the corporation lost nothing. The property was lost to the corporation, not by means of the conveyance, but because of its inability to pay the mortgage debt, for if the conveyance had not been made a decree of foreclosure would have divested the title. Under such circumstances, complaint that the conveyance was not formally authorized is an appeal to purest technicality.

In *Wheeler, Osgood & Co. v. Everett Land Co,* 14 Wash. 630, a corporation was sued on a bond on which it was surety. It objected to its liability on the bond that the board of directors had never auth-

orized the execution of the bond. It appeared, however, that a majority of the directors had consulted concerning the execution of the bond and consented thereto, and this was held sufficient, the Court saying that the contention amounted to no more than a claim of "want of formality in the execution of the bond," and that such a contention should not be allowed to prevail. All the directors of the Brewing Company, as matter of course, knew that it was intended to give the conveyance and approved of it, just as they approved of it after it was given. It would be grossly technical to say the conveyance could not stand because it was not authorized by the board.

(c) *Fraud.*

Schade personally guarantied the mortgage notes given by the Brewing Company to the Trust Company, and in the foreclosure suit he was joined as defendant for the purpose of recovering upon his guaranty; Mrs. Schade being also joined as defendant for the purpose of establishing as against her that the guaranty was a community debt, inasmuch as the stock which the Schades owned in the Brewing Company was community property (Tr., 124-125, *Shuey v. Holmes,* 22 Wash. 193). In consideration of the conveyance, the notes and mortgage were cancelled and surrendered, and, of course, all the parties thereto, the Schades as well as the Brewing Company, were released from any liability thereon. This is the first ground suggested for the charge that the conveyance

was fraudulent, because the Schades, a majority of the board of directors, were personally interested in and profited by the conveyance.

A transaction between corporate officers and the corporation is not void, nor will it be set aside upon mere challenge. This Court has said that a corporate officer may deal with the corporation, and that in such dealings no more is required of him than "that candor and fairness which equity imposes as a guide for dealing between him and the corporation," and that the dealings be "open and free from blame," *Cowell v. McMillin,* 177 Fed. 25, 39. In the later case of *In re Lake Chelan Land Co.,* 257 Fed. 497, it said that the validity of such transactions was to be determined by the rules of "conscience and fairness" which courts of equity have prescribed. The rule in the State courts is the same. *Baker v. Seattle-Tacoma Power Co.,* 61 Wash. 578; *Ritchie v. Trumbull,* 89 Wash. 389.

The same rules govern when a corporate transaction is assailed because it was participated in by corporate officers who were interested in the event.

> "Although the law regards with disfavor contracts made by such directors of corporations with themselves, nevertheless such contracts are not necessarily void. The fact of such relationship does not of itself render the transaction fraudulent. While such a transaction is well calculated to arouse suspiciou, and calls for a 'rigid and severe' scrutiny in its examination, and requires clear and full proof of a valuable and sufficient consideration and of the good faith of

> the parties, still when such examination has been made and such proof has been furnished, the transaction is valid as to creditors and must stand."
>
> *Roy & Co. v. Scott Hartley & Co.,* 11 Wash. 399, 404.

See also: *Budd v. Walla Walla Ptg. Co.,* 2 W. T. 347; *Roberts v. Washington Nat. Bk.,* 11 Wash. 550.

Now, it is undisputed that the debt which was satisfied by the conveyance assailed was a corporate debt, and that Schade's only relation to it was that of a surety. He was, it is true, interested in the discharge of the debt, just as any surety is interested in the discharge of the debt for which he is sponsor. But that was an entirely proper interest, and if he resorted to no improper means to secure the discharge of the debt, his participation in the transaction did not make it questionable. A corporate officer is, of course, under no obligation to loan money to the corporation, or to use his funds or credit for its benefit. *Zeckendorf v. Steinfeld* (Ariz.), 100 Pac. 784. But if he chooses to do so, and the transaction is fair and aboveboard, he is entitled to all the rights, remedies and securities which would be available to a stranger creditor of the corporation. *In re Lake Chelan Land Co.,* 257 Fed. 497; *Thompson v. Huron Lbr. Co.,* 4 Wash. 600; 14a Corpus Juris, 132-135. It follows that if Schade had paid the debt for which he was security, he might, as any other surety might, have compelled the Brewing Company to reimburse him, and for the purpose of reimbursement could

have taken a lien upon or a conveyance of the corporate property. Moreover, there being no question of the justness of the debt due him, his participation as a corporate officer in the transaction by which the lien was given or the conveyance made him would not have been cause for avoiding it. *Brown v. Grand Rapids etc. Co.*, 58 Fed. 286 (opinion by Judge Taft); *Heidbreder v. Superior Ice Co.* (Mo.), 83 S. W. 466.

In the light of these settled rules, an attack upon the conveyance because Schade participated in it, he being interested as a surety in the discharge of the debt, can scarcely be taken seriously. No fraud or collusion between him and the Trust Company is suggested. The debt, a just corporate debt, owing for money borrowed and used in the corporate business, was overdue. The Brewing Company had not a dollar to pay on the debt. Its business was destroyed, and there was no hope that it could ever be resumed. Interest, taxes and insurance were piling up, and a delinquency tax certificate, amounting to nearly $6,000 and bearing 15% interest, had been issued against its property. There had been talk of foreclosure for a year or two (Tr. 97), and finally foreclosure could be staved off no longer and suit was begun. No claim is made that there was any defense to the foreclosure suit. Oh, true, some stock defenses were pleaded in the answers which were put in to the suit; payment, Schade's mental incapacity, etc., etc. (Tr., 146-158), but these, manifestly, were interposed purely to secure delay, and were not *bona fide*. If the debt had been

other than a just corporate debt, if there had been a shred of defense to the foreclosure suit, the plaintiff in this suit would, of course, have so pleaded in her complaint, and would not have rested her case upon the technicalities which are its sole foundation. Look to her bill (Tr. 2-11), and observe that it is utterly barren of any charge or hint of fraud, collusion, or of anything savoring of a defense to the debt and mortgage. The testimony is equally barren of anything of that sort, while every witness speaks of the debt as a just one and of foreclosure as inevitable. In September, 1917, before the foreclosure suit was begun, Schade sent an appeal to the shareholders of the Brewing Company, telling them that the Trust Company was pressing for payment of the mortgage, and that "quick action" in the matter of paying the debt was necessary else the property would be lost (Tr., 170-171). No defense to the debt is suggested; on the contrary, payment is considered the sole hope for saving the property, wherefore the appeal. But the shareholders, evidently, did not respond. Issues were made up in the foreclosure suit by service of the defendants' answers in November, 1917 (Tr., 152, 159), and the case was set for trial when the settlement was made (Tr., 76, 79). That the settlement was made under the duress of the pending suit and the approaching trial is clear. It so appears from the testimony of Mr. Moore, attorney for the defendants in the foreclosure suit, of Mr. Edge, attorney for the plaintiff in that suit, and of Mr. Geraghty,

attorney for the Brewing Company for many years, until he became Corporation Counsel of the City of Spokane (Tr., 75-79, 96-98). It is not claimed that Schade made the conveyance willingly or pleasantly. In a circular letter sent by him to the shareholders some months after the conveyance was made, he speaks bitterly of the company being "forced", "under pressure of legal proceedings", to deed its holdings to the Trust Company (Tr., 172-174). Every sentence breathes the resentment of the angry, unfortunate debtor, who feels that a creditor has demanded his due with too much harshness. It was natural that Schade, his business ruined by what he, no doubt, considered unjust and confiscatory laws, should feel so, and it is not to be expected that he could see the case from the bank's standpoint: the large debt, running for many years, and long overdue, the unpaid interest, taxes and insurance, the ruined business, illegal and evidently never to be resumed, which precluded any hope of payment, save from the sale of the mortgaged property. Be that as it may, this letter, if it stood alone, would dispel any suspicion of collusion between Schade and the Trust Company. It proves conclusively that Schade did not make the conveyance because of his personal interest or hope of personal gain, but that he was forced to make it by the pressure of the foreclosure suit, and because by making it he gained advantages for the Brewing Company and its shareholders which would have been lost if the suit had gone to trial. There is,

plainly, no room for suspicion of personal interest and personal gain, or of fraud, actual or constructive, in the transaction. That being so the transaction is unassailable.

The second charge of fraud springs from the following state of facts: The deed and option to repurchase agreement left the property affected in the possession of both parties, the Brewing Company and the Trust Company. The Trust Company was given the right to lease the property, but it was provided that the lease should not interfere with, and should terminate upon, the exercise of the option. Any income derived from the property during the option period was to go to the Trust Company, but the amount thereof, after the deduction of sundry enumerated charges, was to be credited on the option price if the option was exercised. Both parties were to use their best endeavors to sell the property, but no sale could be made save on terms satisfactory to both. The Brewing Company was to have keys to all the buildings, and the right of entry for purposes of inspection or exhibition to prospective purchasers. Among other provisions appeared the following:

> "IT IS FURTHER UNDERSTOOD AND AGREED that if during the lifetime of this option said second party (the Brewing Company) desires to conduct in the bottling works on said premises a business of its own, or if B. Schade or Sophia Schade, his wife, shall personally operate a business in said bottling works,

> that no rental shall be charged therefor as long as said business is conducted by the said Schades personally or by said second party on its own account, but that the same shall not be leased or sublet by the Schade Company or the Schades to any other party or parties whatsoever."
> (Tr., 18-19.)

The right thus granted to the Schades, it is said, was such a personal gain, was of such personal interest to them, that their participation in the transaction invalidated it.

Under the decisions of this Court and of the Supreme Court of the State, a corporate officer may participate in a corporate transaction in which he is personally interested if his connection therewith is "open and free from blame", and his course is consistent with the rules of "conscience and fairness" which control courts of equity. It is manifest, therefore, that giving the Schades the right to operate the bottling works, subordinate to the prior right of the Brewing Company to the works if it desired them, cannot be criticized unless thereby the Brewing Company lost something of value to which it was entitled, or the Schades gained something to which they were not entitled. It is folly to claim that any such element was present. Nothing was taken from the Brewing Company. It had conveyed its property in fee simple in payment of a just debt which it owed, and it had no right to any possession and use of the property save such as the grantee chose to concede it. The grantee gave it the right to operate the bottling works if it chose. What did

it lose, what could it lose, by reason of the grantee having given to the Schades an alternative right, a right contingent upon the Brewing Company not exercising its right, to operate the bottling works? Manifestly, nothing. It is not claimed that the Brewing Company desired to or could operate the works. Its history shows it neither desired to nor could do so. The agreement in question was made in January, 1918. Washington went dry in January, 1916. None but a soft drink business could be conducted. For a short time after Washington became dry the Brewing Company had essayed the soft drink business—"not a great length of time and on a very small scale"—and had abandoned the business because it did not pay (Tr., 62-64). It was left without "a dollar's worth of money", it could not pay its taxes (Tr., 64), indeed, could not pay insurance or any other charge that was necessary to be met to keep the property up (Tr., 92-93, 16, 169-170). It was, consequently, without the means to operate the bottling works if it had desired, and it had not the desire because it had tried the soft drink business and failed. Evidently, then, it lost nothing because the Schades were given a subordinate right, or, if you please, an equal right, to operate the bottling works.

Conversely, the Schades gained nothing through the right conceded them. They never exercised it, and could not have expected to exercise it. They knew the Brewing Company's effort to conduct a soft drink business was a failure, and could not have

expected to better the possibilities of the business by running it for themselves instead of for the corporation. Reading the minutes of the directors' meetings through from the beginning of 1918 until the property was finally lost in July, 1919, it will be observed that the only thought in the directors' minds, the one thing to which they bent their energies, was the sale of the property (Tr., 59-61). If it had been possible to put the property to any profitable use, it is evident that some effort in that direction would have been made. Moreover, "The proof of the pudding is in the eating." The Trust Company has had control of the property for over three years. When the deed was made to it, in January, 1918, it had an investment of $63,650, including the original debt, in the property (Tr., 16). In September, 1919, when it offered to let the shareholders of the Brewing Company in as proportionate owners of the property if they would pay a proportionate part of the debt against it, the amount of the investment had risen to $76,000 (Tr., 169-170). At the time of the trial it had increased to $85,000 (Tr., 92). During that entire time the property has not yielded one cent of return; as Mr. Malott, vice-president of the Trust Company, testified: "We have not received any income from the property whatever" (Tr., 92). The situation is eloquent. The property as an entity was designed for a brewery, and as an entity it had no value for any other purpose. The prohibition wave stripped it of all value as an entity. After the futile effort

to get some revenue out of it from the making of soft drinks, those in interest had no hope for realizing anything from it save through the piecemeal sale of the machinery, the scrap value of the buildings, and the speculative value of the realty. It is idle folly to talk of the right given to the Schades to use the bottling works having taken anything of value from the Brewing Company, or having given anything of value to the Schades, or of being an inducement to the Schades to fail in their duty as corporate officers so that they might personally profit.

One word concerning the position of these shareholders who prate of the fraud of the Schades; especially of plaintiff, Schade's niece, who does not let his death (Mrs. Schade now appears as his executrix Tr., 49, 114), disturb her charge of fraud.

When business was good and dividends were frequent, the shareholders were full of interest in the business and regularly attended the meetings. As the dry wave rose higher and there were no more dividends, their interest fell off and they no longer attended the meetings. Finally the Schades and Stritesky were left entirely alone to look after the corporate affairs and save what they could from the wreck (Tr., 62-63). When foreclosure of the mortgage was threatened, Schade appealed to the shareholders for counsel and assistance (Tr., 170-171). If he received either, it does not appear. The fore-

closure suit was brought, issues were joined, and the case was set for trial. Under the duress of that suit, and because there was no escape, he conveyed the property in satisfaction of the debt, and by the option to repurchase secured an eighteen months' redemption period instead of the twelve months' period the statute would have given him. This, it was hoped, would afford him time to make a turn and save something from the wreckage (Tr., 78-79). There is nothing to impugn his good faith, and the fact that he owned 2,600 shares of the 5,000 issued shares makes it certain that he did not make the conveyance in order to defraud the shareholders. The self-evident fact is that the shareholders left him to bear the burdens of the ruined corporation alone. He did what he could to save something, and it is grossest injustice to charge his failure to fraud, instead of to prohibition and the financial stresses of war time, the actual factors which dominated the situation.

The appellants' position is further discredited, not to say exposed as downrightly dishonest, by their subsequent conduct. After the expiration of the option to repurchase, in August, 1919, the Trust Company sent a circular letter to each shareholder of the Brewing Company, offering to give him an interest in the former property of the Brewing Company, proportionate to his shareholdings therein, if he would pay a proportionate amount of the entire debt and investment of the Trust Company (Tr., 165-169). Seven or eight took advantage of the offer (Tr., 94).

Appellants, of course, were not of that number. The property, it seems, is not of sufficient value to them to permit of their paying any part of the just debt which is an incumbrance upon it. It is of sufficient value, however, to induce them to bring a suit for the purpose of defeating a just debt, and getting the property back freed from incumbrance. Well, there are a good many people who see no harm in endeavoring to escape the payment of their just obligations, so it is not particularly surprising to find appellants in that position. It is extremely surprising, though, to find them appealing to a court of equity for aid in their adventure.

It is said that the property of the Brewing Company was of great value, and that it has been lost to the shareholders by the conveyance. Were it of even greater value than is claimed for it, the shareholders would be in no position to complain that they had lost it by the conveyance. The justness and validity of the debt and mortgage which incumbered the property are not questioned. Before the foreclosure suit was begun, they were informed by Schade that the Trust Company was pressing for payment, and that quick action was necessary if they wished to save the property. Why did they not respond to his appeal and advance the funds to pay the incumbrance? Early in 1918 they were informed of the situation by both the Trust Company and Schade, told that either the property must be sold or they advance the means

for its redemption, and were urged to do something before the expiration of the redemption period to save it for themselves (Tr., 93-94, 172-174). Again they would not act. The eighteen months' redemption period expired, the Trust Company freely offered to give the property back to them if they would pay the debt, or upon payment of parts of the debt to give them proportionate interests in the property. Seven or eight accepted, the remainder declined. Whatever the value of the property, it is clear that it was not lost to the shareholders because of the conveyance, but because of their obstinate refusal to pay any part of the debt which incumbered it.

But the values stated by counsel are absurd. They are arrived at by ascertaining the cost of the buildings and what they could have been replaced for, and then taking the opinions of real estate agents and a machinery man as to the value of the land and of the machinery. Such figures, of course, have not the slightest evidential value in this case. The question is not of the speculative value of the property. It is of what could be realized from the property in order to pay the incumbrance upon it. The incumbrance was originally but $50,000, although by January, 1918, when the conveyance was made, it had risen to $63,000, due to delinquent interest, delinquent taxes, delinquent everything. The brewing business was destroyed, and the incumbrance could not be paid and foreclosure averted unless by sale of the property. Before the foreclosure suit was begun and after, be-

fore the conveyance was made and after, before the redemption period had expired and after, strenuous efforts were made to sell the property for enough to pay the incumbrance and leave something for the shareholders, and it could not be done. During the same period the shareholders were besought again and again to pay the debt and take the property, and they would not. In the face of these facts, what avails it to take opinion values, speculative values, as the basis for large talk about the injury done the shareholders by the conveyance? If there were real value, salable value, in the property exceeding the incumbrance upon it, it would have been sold for enough to pay the debt, or the shareholders would have paid it and taken the property. Unquestionably the property cost much more than the incumbrance. It was designed, acquired and constructed to be used, as an entity, for a brewing plant. So long as the brewing business remained lawful, the property, as an entity, was no doubt of considerable value. The prohibitory laws, State and National, destroyed the business and with it the substantial value of the property. There remained the speculative value of the land for any useful purpose to which it might be adaptable, the scrap value of the material in the buildings, and the piecemeal value of the machinery, so far as it was adaptable to other purposes. What the real salvage value was is best shown by the fact that it could not be sold for enough to pay the in-

cumbrance, and that the shareholders would not pay the debt in order to get the property.

II.

Whether our position upon the points heretofore discussed is or is not sound, it is nevertheless clear that this suit is not maintainable. Appellants do not offer to do equity or restore the *status quo* if the conveyance be set aside. On the contrary, they resent the notion that anything of the sort can be required of them, and inveigh against Judge Rudkin because of his belief that in seeking the aid of a court of equity they should conform to equitable principles. Their conduct clearly deprives them of any right to equitable relief.

Let us briefly review the pertinent facts before presenting the controlling authorities.

The transaction involved originated in 1914, when the Trust Company loaned the Brewing Company $50,000, and took its notes therefor, secured by a mortgage on all its property (Tr., 92-93, 124-144). For emphasis we repeat that the justness and validity of the debt and mortgage have never been questioned. Idaho went dry in 1915, Washington in 1916, Oregon about the same time, and in 1917, with the adoption by Congress of the resolution submitting the Eighteenth Amendment, no doubt remained that the whole United States would soon be dry. The business of the Brewing Company was destroyed, it was left without a dollar, and it had no resource for the pay-

ment of the incumbrance upon its property except a sale of the property, unless, perchance, its shareholders chose to come to its rescue. They did not choose to do so, and a foreclosure suit was begun. By the terms of the settlement under which the mortgaged property was conveyed in payment of the mortgage debt, the Trust Company paid taxes and insurance premiums on the property amounting to about $6,400 (Tr., 16). By reason of the settlement the foreclosure suit was dismissed with prejudice, and the notes and mortgage were surrendered and canceled (Tr., 175, 95-96). By September, 1919, when the Trust Company, after expiration of the redemption period, offered the property to the shareholders if they would pay the debt, or participation in the property if they would pay a part of the debt, its expenditures for taxes, insurance, repairs, judgment, etc., amounted to an additional $5,000 (Tr., 169-170). Since then its expenditures have gone on, of course, until at the time of the trial it had sunk about $85,000 in the property (Tr., 92). In 1920 it received $12,000 from the sale of certain machinery from the plant (Tr., 122-123), but that meant, of course, an impairment by so much of the original security it held for its original debt of $50,000, and is not income arising from use of the property which would mitigate the loss it has suffered by its advancement of taxes, insurance, etc., since it has been in possession of the property.

Now what seeks plaintiff by this suit? We do not

refer to her co-appellant, for it adopts her position. Downrightly, barefacedly, she seeks the setting aside of the deed to the Trust Company and the return of the property to the Brewing Company, discharged of all the claims of the Trust Company against it. Neither in the body of the bill nor in the prayer is there the slightest suggestion that equity requires aught of her, or that she is willing to do equity if aught be required of her (Tr., 2-12). The Brewing Company, to whose possession she demands that the property be returned, had borrowed money from the Trust Company and given it security by a mortgage on the property. The debt has been cancelled and the security released. She neither offers to pay the debt nor to restore the security. For several years the property was abandoned by the Brewing Company and its shareholders. Had not the Trust Company paid the taxes upon it, and kept the buildings and machinery insured and in repair, it would have been lost to them ere now. She neither offers to repay the advances nor to agree that they may be made a charge upon the property. There is nothing in the testimony to relieve the inequity of the bill. No offer to pay the debt or restore the security appears; no offer, even, to repay the disbursements made to save the property for plaintiff and the other shareholders on whose behalf she sues is shown. And in his opinion Judge Rudkin remarks that it was conceded that the shareholders did not have the means to effect a redemption, and, further, "that if they had the means

it would not be deemed advisable to employ them in that way" (Tr., 47). The case, then, is an undisguised attempt to obtain the aid of a court of equity to set aside a conveyance and obtain the return of property, relieved from valid incumbrances upon it, and without the repayment of money loaned upon its security and advanced for the purpose of preserving it.

Under the local law of Washington governing the relation of mortgagor and mortgagee, without resort to general equitable principles, appellants cannot, taking the position that they do, maintain this suit. No more can be said of the conveyance than that it was voidable. It conveyed an apparent perfect title, and the decree of a court of equity was required to avoid it; witness this suit and the allegations in plaintiff's bill that it was beyond the power of the Brewing Company or its officers "to have said deed * * * * set aside without a resort to a court of equity", and that "plaintiff is remediless at law and the exercise of the equitable powers of this Court are necessary to redress plaintiff's wrongs * * * in the conveying of all of the property", etc. (Tr., 11.) The Trust Company went into possession under the deed, and is now in possession. It is the settled law in Washington that if a mortgagee goes into possession of the mortgaged property, albeit without the consent of the mortgagor, under a void instrument purporting to give him title, e.g., a void decree of foreclosure and sale, he is to be regarded as a mortgagee in possession, and entitled to all the benefits accruing to that position.

Neither the mortgagor, therefore, nor any one claiming under him, is entitled to a setting aside of the sale, recovery of the property, or any other relief, unless he offers to do equity and pay what is justly due the mortgagee, including taxes paid and repairs and improvements made by the mortgagee while in possession. *Investment Securities Co. v. Adams,* 37 Wash., 211, *Sawyer v. Vermont L. & T. Co.,* 41 Wash., 524.

In the case at bar the plaintiff sues on behalf of the Brewing Company. She occupies a purely representative position. She cannot maintain the suit if it could not; she is not entitled to relief if it would not be. Under the above decisions it could not maintain this suit without offering to pay the Trust Company what was justly due it, and so she cannot maintain it without making such an offer.

It may be remarked that as the above decisions relate to the respective rights of mortgagor and mortgagee, arising from instruments under the State law, they establish a rule of property which will be followed by the Federal courts. *Parker v. Dacres,* 130 U. S., 43. However, they are but the application to local laws of a rule long settled in the Federal courts. *Bryan v. Kales,* 162 U. S., 411, *Romig v. Gillett,* 187 U. S., 111.

Turning to general equitable principles, one who seeks to rescind a contract as *ultra vires,* for fraud, etc., must put the other party *in statu quo. Grymes v.*

Sanders, 93 U. S., 55, *Pullman's Car Co. v. Transportation Co.,* 171 U. S., 138, *Sherbloom v. Faussett,* 99 Wash., 680. In *Alaska etc. Co. v. Solner,* 123 Fed., 855, this Court held that a corporation could not maintain a bill to set aside an unauthorized sale of the corporate property without showing a tender back of the consideration received, or without an unequivocal offer in the bill to return it, saying that "The tender must be without qualification or conditions," under the fundamental rule that "He who seeks equity must do equity." In *Jenson v. Toltec Ranch Co.,* 174 Fed., 86, 92, the Circuit Court of Appeals for the Eighth Circuit, dealing with an *ultra vires contract,* said:

> "Courts of equity do not restore money or property to corporations that have obtained them by means of contracts or conveyances beyond their powers, until those corporations first restore the money or property they have secured thereby, or its value. He who seeks equity from these courts must first do equity."

In *Shafer v. Spruks* (C.C. A., 3d Circ.), 125 Fed., 480, the receiver of a corporation brought suit to set aside an issue of bonds secured by a mortgage upon the corporate property. In denying relief the Court said:

> "As the receiver simply stands in the dairy company's shoes, the case is one between that company and the holder of its bonds. Moreover, it is the dairy company that is here seeking relief in a court of equity, a right to resort to whose aid is always based on that golden rule of equitable procedure, that he must do, who seeks, equity."

* * * * * * * * *

> "As noted above, no rights of third parties are here involved. The case is one between the original parties, the obligor, and the holder of the bond. Under such conditions and with the obligor receiving and still retaining the par proceeds of the bonds, it has no standing to invoke the aid of a court of equity to repudiate and disavow the act which secured the retained benefit from its obligee. This is in accord with the general salutary principle that a principal cannot retain the benefit of ultra vires acts and at the same time repudiate them; for, if, as held in *Chapman v. Douglass,* 107 U. S., 355, 2 Sup. Ct. 62, 27 L. Ed. 378, a legal liability springs from a moral duty to make restitution, it logically follows that a failure to make such restitution creates an equitable disability in him who inequitably retains."

The rule is the same in the State courts. *Graton & K. Mfg. Co. v. Redelsheimer,* 28 Wash., 370, *Flanagan v. American etc. Co.,* 108 Wash., 569, *Moore v. American Sav. Bk.,* 111 Wash., 148.

What have appellants to urge to overcome the salutary rule declared in the above decisions? Principally, that the conveyance was *ultra vires,* and that a court of equity is so avid to upset *ultra vires* transactions that it will disregard the equities involved. Such a position needs no remark. Next they say that the Trust Company gave nothing and the Brewing Company received nothing except through the medium of the original $50,000 loan and the mortgage given to secure it, and that no benefit was conferred and nothing of value parted with by reason of the conveyance, wherefore equity demands nothing as a condi-

tion to its avoidance. If the premise were true the conclusion would be false. The Trust Company is a mortgagee in possession, and therefore the instrument under which it went into possession cannot be avoided and it be ousted without payment of the mortgage debt. But the premise is false. In consummation of the settlement under which the conveyance was given, and subsequent to and by virtue of the conveyance, the Trust Company paid out between $10,000 and $15,000 for taxes, insurance and repairs on the property. It was necessary to make these payments in order to conserve the property, and if the Brewing Company gets the property back by this suit, it will, of course, be benefited by those expenditures.

Finally, it is urged that they received nothing and therefore cannot be required to return anything. Analyzed, their argument is that it was the Brewing Company which received the benefit of the transaction; that they, mere shareholders, got nothing, and therefore, while they sue upon a cause of action which belongs to the corporation, and whatever they recover will go to the corporation, yet they are under no obligation to do the equity which wuld have been demanded of the corporation had it brought the suit.

The proposition is rather staggering. They sue for the corporation, to recover its property, and whatever they get will go to it, yet they cannot be required to return what it would have been forced to return in order to recover its property. If this be sound, how easy it will be for a corporation to escape the burden

of doing equity. It need but refuse to sue, a shareholder sues, and, Presto! the thing is done. But of course the position is not sound. Where a shareholder sues on behalf of a corporation, his cause of action is a derivative one, and he "who asserts a derivative cause of action must establish the existence of a cause of action in the party whose rights are sought to be enforced. A cause of action cannot be derived from a source in which it does not exist." *Waters v. Horace Waters Co.* (N.Y.), 94 N.E., 602. That the cause of action which the shareholder possesses is the same as that of the corporation, no greater, no less, see 6 Fletcher, Cyc. Corporations, §4061, 2 Machen, Corporations, §1183. To the particular point here involved, we quote from the syllabus in *Collins v. Penn.-Wyo. Cop. Co.,* 203 Fed., 726:

> "Stockholders of a corporation in a representative action were not entitled to set aside a mortgage securing bonds issued by the company to pay debts, without offering to return the money received from the bondholders, so as to place them in statu quo."

We quote also from the syllabus in *Wrightsville Hdw. Co. v. McElroy* (Pa.), 98 Atl., 1052:

> "A bill in equity by minority stockholders of a Pennsylvania corporation for the cancellation of bonds issued to take up notes of the corporation, given in payment for the bonds of a corporation of another state, is properly dismissed, where the Pennsylvania corporation has not offered to return either the notes or bonds to the foreign corporation."

The Supreme Court in its opinion, quoted and approved the following language from the opinion of the chancellor in dismissing the bill:

> "Even if it was conceded that the issue of the bonds, or of both the notes and bonds of the Wrightsville Hardware Company, was ultra vires, still the rule of law is the same with corporations as with individuals. Neither can retain the profits of a transaction, or anything of value received from the other party thereto, and set up ultra vires as a defense to the enforcement of the contract. To do so would be unconscionable, and is therefore impossible in a court of equity. He who seeks equity must do equity. The cases are legion, and from many courts, in which this sound rule of equity and common honesty has been enforced."

The syllabus in *Spencer v. Clarke,* 1 N.Y. Supp., 533, is thus:

> "A complaint by a stockholder of a corporation seeking to enforce a right of the corporation to have certain bonds issued by it, and the mortgage given to secure the same, canceled, is defective on demurrer if it does not contain an offer to restore to the holders of the bonds what the corporation has received therefor."

See also: *Fleckenstein v. Waters* (Mo.), 61 S.W., 615, *Jones v. Green* (Mich.), 88 N.W., 1047, and *Harpending v. Munson,* 91 N.Y., 650.

Appellants point out that they own but a tithe of the corporate stock, and ask upon what principle they can be required to pay all the corporate obligation as a condition to maintaining the suit.

If a shareholder's suit to recover corporate property

was on behalf of himself alone; if for the purposes of such a suit he was considered to be an undivided owner of the corporate property, proportionate to his shareholdings, and his recovery would be limited to his proportionate share of such property, there would be more of reason in the claim that he ought not to be required to return all the benefit which the corporation received from the transaction sought to be avoided. If a suit brought on such a theory were conceivable, it would be conceivable that it should be held that as the shareholder could recover but his share of the property, he should be required to return no more than his share of the benefits received. But, a shareholder's suit being what it is, reason balks at the point appellants would make. This suit is on behalf of the corporation, of all the shareholders in the corporation. If it succeeds the entire property will go back to the corporation, for the benefit of all its shareholders. As appellants assumed to represent the corporation and all its shareholders for the purpose of recovering the corporate property, they must assume to represent the corporation and all its shareholders for the purpose of offering to do what it is necessary should be done before the property can be given back to the corporation. They have done nothing of the sort; on the contrary, they have flatly declared that neither the corporation or its shareholders were able or willing to pay anything or return any benefit received. The situation and their position was thus tersely summed up by Judge Rudkin:

> "The mortgage has been satisfied of record; the mortgagee has been placed in possession by the mortgagor, and the mortgage debt has not been paid. Under such circumstances the utmost relief that could properly be granted to either the corporation or the stockholders would be a right of redemption. If under any circumstances this suit could be treated as a suit of that character or for that purpose, it should at least appear that either the corporation or the stockholders are ready and willing to pay the amount due on redemption. No such readiness or willingness is averred in the pleadings, and no such readiness or willingness was disclosed at the trial. Counsel frankly conceded that the stockholders did not have the means to effect a redemption, and further conceded that if they had the means it would not be deemed advisable to employ them in that way."

A court of equity, in other words, is asked to relieve the corporation of a debt of $85,000, the benefits of which it has received and the justness of which is not questioned, and to give the mortgaged property back to the corporation, freed of all incumbrances upon it, for no better reason than that the corporation and its shareholders are unable, or do not deem it "advisable", to employ their means in payment of the debt!

Several authorities are cited by appellants which are supposed to sustain their position that it is unnecessary for them to offer to do equity in order to obtain relief. The first is *Franklin v. Havalena Mining Co.* (Ariz.), 141 Pac., 727. In that case a demurrer to a complaint upon the ground that it did not state

sufficient facts to constitute a cause of action was sustained, and the sole question was whether the stated facts were sufficient. The facts involved, therefore, were simply such as the plaintiff chose to state as ground for relief and, quite naturally, did not disclose any benefit received by the corporation from the transaction attacked or any equities in the other parties to the transaction. It showed merely that officers of a corporation, without authority, had made a highly disadvantageous lease of its property, and that the lessees had gone into possession of the property thereunder. It showed that the lessees had paid nothing and that the corporation had received nothing because of the lease, but that, on the contrary, the lesses had taken possession of the leased property and made large profits therefrom. The court held that the complaint was sufficient without any offer to do equity because it did not "disclose a single equity" in favor of the defendants. It scarcely needs remark that if there was no equity in the defendants' possession of the property, there need be no offer to do equity as a condition to ousting them.

A second case is *Citizens Savings etc. Co. v. Railway Company,* 182 Fed., 607. This again was disposed of on demurrer to the bill. It was a suit to set aside certain juggling contracts, or so alleged to be, by which one railway company had acquired possession of other railway lines without authority and in wrong of the shareholders of the latter. It was expressly declared in the opinion that the bill disclosed nothing

whatever of value received by the corporation on whose behalf the suit was brought, nor nothing of detriment to the corporation whose possession of the property was attacked, and under such conditions it was held, quite naturally, that there need be no offer to do equity.

The other decisions cited are so utterly and absurdly irrelevant to the case at bar that it would be idle to remark upon them.

We submit that Judge Rudkin's decision that the appellants' case is "entirely devoid of equity" is right, and should be affirmed.

Respectfully submitted,

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